fair market value of distributed Property B ($10,000) is less than the adjusted tax basis of A's partnership interest. Recognizing A's increased adjusted tax basis as a result of the shift in liabilities is consistent with the purpose of section 737 and this section. Section 737 requires recognition of gain only when the value of the distributed property exceeds the distributee partner's adjusted tax basis in the partnership interest. The $10,000 recourse liability is a bona fide liability of the partnership that was undertaken for a substantial business purpose and A's and B's agreement that A will assume responsibility for repayment of that debt has substance. Therefore, the increase in A's adjusted tax basis in A's interest in the partnership due to the shift in partnership liabilities under section 752 is respected, and A recognizes no gain under section 737.

§ 1.737–5 Effective date.

Sections 1.737–1, 1.737–2, 1.737–3, and 1.737–4 apply to distributions by a partnership to a partner on or after January 9, 1995.

Dated: December 13, 1995.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

Approved:

Leslie Samuels,

Assistant Secretary of the Treasury.

[FR Doc. 95–30870 Filed 12–22–95; 8:45 am]

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26 CFR Parts 1 and 602

[TD 8638]

RIN 1545–AT44

Certain Transfers of Domestic Stock or Securities by U.S. Persons to Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: These temporary regulations provide the public with guidance necessary to comply with the Tax Reform Act of 1984. These regulations amend the Income Tax Regulations with respect to certain transfers of stock or securities of domestic corporations by United States persons to foreign corporations pursuant to the corporate organization, reorganization, or liquidation provisions of the Internal Revenue Code. This Treasury decision also removes certain of the existing temporary regulations regarding transfers by U.S. persons of stock or securities of both domestic and foreign corporations. This action is necessary to update the existing temporary regulations and to reflect certain of the changes announced by Notice 87–85 (1987–2 C.B. 395) (with respect to transfers of both domestic and foreign stock or securities) and by Notice 94–46 (1994–1 C.B. 356) (with respect to transfers of stock or securities of a domestic corporation). The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the Federal Register. When finalized, the regulations under section 367(a) relating to the transfer of stock or securities will integrate the regulations herein with the 1991 proposed regulations relating to transfers of stock or securities (see Proposed Rule §§ 1.367(a)–3 and 1.367(a)–8, published at 56 FR 41993, August 26, 1991).

EFFECTIVE DATE: April 17, 1994. For further information, see the Applicability and Effective Dates section under **SUPPLEMENTARY INFORMATION.**

FOR FURTHER INFORMATION CONTACT: Philip L. Tretiak at (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Applicability and Effective Dates

These regulations are generally applicable to transfers occurring after April 17, 1994, the effective date of Notice 94–46. However, the active trade or business requirement (described in § 1.367(a)–3T(c)(1)(iii) of the temporary regulations herein), which was not contained in Notice 94–46, is effective for transfers occurring January 25, 1996. Moreover, these regulations remove as "deadwood" paragraphs (c)(1) through (c)(4), (d), (e), (f), (g)(1)(iii) and (h)(1) of § 1.367(a)–3T of the existing temporary regulations with respect to transfers occurring after December 16, 1987, the effective date of Notice 87–85.

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1478. Responses to this collection of information are required in order for U.S. shareholders that transfer stock or securities in section 367(a) exchanges to qualify for an exception to the general rule of taxation under section 367(a)(1).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of this issue of the Federal Register. Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On May 16, 1986, temporary and proposed regulations under sections 367 (a) and (d) and section 6038B were published in the Federal Register (51 FR 17936). These regulations were published to provide the public with guidance necessary to comply with changes made to the Internal Revenue Code by the Tax Reform Act of 1984. Included in the 1986 temporary regulations was § 1.367(a)–3T, concerning transfers of stock or securities of domestic or foreign corporations by U.S. persons to foreign corporations. Subsequently, the IRS and the Treasury Department issued Notice 87–85 (1987–2 C.B. 395), which set forth substantial changes to be made to § 1.367(a)–3T, effective with respect to transfers occurring after December 16, 1987. A further notice of proposed rulemaking, containing rules under section 367(a), as well as under section 367(b), was published in the Federal Register on August 26, 1991 (56 FR 41993). The 1991 proposed section 367(a) regulations were generally based upon the positions announced in Notice 87–85, but the regulations made certain modifications to Notice 87–85, particularly with respect to transfers of stock or securities of foreign corporations.

Most recently, the IRS and the Treasury Department issued Notice 94–46 (1994–1 C.B. 356), announcing modifications to the positions set forth in Notice 87–85 (and the 1991 proposed regulations) with respect to transfers of stock or securities of domestic corporations occurring after April 17, 1994. The temporary regulations set forth herein generally incorporate the modifications announced in Notice 94–46. The notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the Federal

Register supplements and, where inconsistent with, supersedes, the 1991 proposed regulations with respect to transfers of domestic stock or securities occurring after April 17, 1994.

Notice 94–46 announced that the regulations under section 367(a) would be amended to deny nonrecognition treatment to the transfer of stock or securities of a domestic corporation by a U.S. person to a foreign corporation if all U.S. transferors owned in the aggregate 50 percent or more of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the exchange. (Under the approach taken in Notice 87–85, transfers of domestic stock or securities occurring prior to April 18, 1994 (and after December 16, 1987) were generally denied nonrecognition treatment only in the case of a single U.S. transferor that owned more than 50 percent of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer or of a U.S. transferor that held at least 5 percent (but no more than 50 percent) of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer and that failed to enter into a gain recognition agreement.)

In Notice 94–46, the IRS and the Treasury Department invited comments on possible exceptions to the general rule set forth in the Notice, specifically with respect to cases where (i) a domestic corporation is acquired by a foreign corporation that is engaged in an active trade or business and that, prior to the transaction, is unrelated to the acquired corporation or its shareholders, or (ii) the transferee foreign corporation is a controlled foreign corporation (within the meaning of section 957) after the transfer. After consideration of the comments received, the IRS and the Treasury Department have concluded that no exceptions to the general rule are warranted.

In the Notice, the IRS and the Treasury Department also invited specific comment on whether special rules should be provided to determine the ownership of the transferee foreign corporation in cases where the corporation is publicly traded. As described below, in response to comments received, the ‘‘cross-ownership’’ rules of Notice 94-46 have been modified in a way that will ameliorate the burdens of identifying shareholders of publicly traded (or widely-held) corporations and that should reduce the impact of the general rule on business combinations involving unrelated U.S. and foreign corporations that are engaged in the active conduct of a trade or business.

Need for Temporary Regulations

The rules contained in this Treasury decision provide taxpayers with guidance necessary to comply with Notice 94-46, which was effective with respect to transfers of stock or securities of domestic corporations to foreign corporations occurring after April 17, 1994. The provisions of Notice 94–46 were made immediately effective to forestall certain tax-avoidance transfers by U.S. persons of the stock of U.S.-based multinationals to foreign corporations. Because of the Notice’s immediate effective date, there is a need for implementing regulations on which both taxpayers and the Service may rely with respect to current transfers.

Based on these considerations, it is determined that immediate regulatory guidance will ensure the efficient administration of the tax laws and that it would be impracticable and contrary to the public interest to issue this Treasury decision with prior notice under section 553(b) or subject to the effective date limitation of section 553(d) of title 5 of the United States Code.

Explanation of Provisions

Section 367(a)(1) generally treats a transfer of property (including stock or securities) by a U.S. person to a foreign corporation in connection with an exchange described in section 332, 351, 354, 356 or 361 as a taxable exchange unless the transfer qualifies for an exception to this general rule. Temporary regulations published on May, 16, 1986 (TD 8087) provided exceptions in the case of certain transfers of stock or securities of domestic and foreign corporations (see § 1.367(a)-3T). Notice 87–85 announced modifications to those exceptions for transfers of domestic or foreign stock or securities occurring after December 16, 1987. Proposed regulations issued on August 26, 1991 largely incorporated the positions set forth in Notice 87–85, and expanded the application of section 367(a) with respect to certain transfers of stock or securities of foreign corporations. Notice 94–46 announced modifications to the exceptions originally announced in Notice 87–85, effective with respect to certain transfers of stock or securities of domestic corporations occurring after April 17, 1994.

Both the temporary regulations herein and the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the Federal Register generally incorporate the positions taken in Notice 94–46, with modifications as described below. As indicated previously, Notice 94–46 did not modify the positions taken in Notice 87–85 governing the transfer of stock or securities of a foreign corporation. Until the 1991 proposed regulations are finalized, the positions originally announced in Notice 87–85 will continue to govern the availability of section 367(a) exceptions for transfers of stock or securities of foreign corporations.

In addition to implementing the positions announced in Notice 94–46, this Treasury decision removes those portions of § 1.367(a)–3T of the 1986 temporary regulations that Notice 87–85 announced would no longer be applicable with respect to stock transfers occurring after December 16, 1987. This includes removal of the exceptions in paragraphs (c) (1) through (4) (providing exceptions for certain transfers of domestic stock or securities); of paragraph (d) (providing exceptions for certain transfers of foreign stock or securities, including an exception for transfers to a foreign corporation organized in the same foreign country as the corporation the stock of which is being transferred); of paragraph (e) (involving exceptions where stock is an operating asset or where there is a consolidation of an integrated business); and of paragraph (f) (exceptions where U.S. transferors obtain a limited interest in the transferee foreign corporation).

The temporary regulations herein also incorporate (in paragraph (a)) the 1991 proposed regulations’ restatement of the general rule applicable to outbound stock transfers (see Prop. Reg. § 1.367(a)–3(a)). This restatement revises the general rule contained in the 1986 temporary regulations to reflect changes to section 367 made by Congress after promulgation of those regulations. For example, the 1986 temporary regulations’ statement of the general rule included transfers of stock or securities in section 332 liquidations as one of the transactions covered by section 367(a) (see § 1.367(a)–3T(a)). The restatement of the general rule in the temporary regulations herein removes the reference to section 332 because an outbound transfer of stock or securities pursuant to a section 332 liquidation is now covered by section 367(e)(2) and the regulations under § 1.367(e)–2T. Even though the temporary regulations under § 1.367(e)–2T have sunset (because they were promulgated as temporary regulations on January 12, 1990 (TD 8280) and were not finalized within three years of that date), the Service announced its intention to follow the principles of those regulations in the preamble to the final regulations under section 367(e)(1) (see the preamble to the final section 367(e)(1) regulations in TD 8472, adopted January 15, 1993).

The revised statement of the general rule herein refers explicitly to transfers that may be indirect or constructive. Thus, transactions that are recharacterized as indirect or constructive stock transfers will be subject to the section 367(a) stock transfer regulations and will be taxable unless an exception applies.

The restatement of the general rule herein is not intended to change the 1986 temporary regulations' treatment of a case in which stock or securities of a foreign corporation are transferred pursuant to a reorganization described in section 368(a)(1)(B), including a transaction that is described in both section 368(a)(1)(B) and section 351. It is anticipated, however, that the final regulations issued with respect to an outbound transfer of foreign stock or securities will incorporate the principles of the 1991 proposed regulations, and thus, for example, a transaction described in both section 368(a)(1)(B) and section 351 will be subject to section 367(a).

Notice 87–85 and the 1991 Proposed Regulations

Under Notice 87–85 and the 1991 proposed regulations, a U.S. transferor of stock or securities that owns five percent or more of either the total voting power or the total value of the transferee foreign corporation immediately after the transfer generally is not subject to current taxation under section 367(a)(1) if that transferor enters into a gain recognition agreement (GRA). The term of the GRA is five years if all U.S. transferors, in the aggregate, own less than 50 percent of both the total voting power and the total value of the stock of the transferee foreign corporation immediately after the transfer, or ten years if the U.S. transferors, in the aggregate, own 50 percent or more of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer. U.S. transferors that own an interest of less than 5 percent in the transferee foreign corporation immediately after the transfer are not taxable under section 367(a)(1) and are not required to enter into a GRA. If a single U.S. transferor transfers stock or securities of a domestic corporation and owns directly or by attribution more than 50 percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer, gain is recognized on the exchange.

The determination whether (i) a U.S. transferor owns five percent or more of the transferee foreign corporation immediately after the transfer, (ii) U.S. transferors own in the aggregate 50 percent or more of the transferee foreign corporation (and, thus, whether a 10-year GRA is required), or (iii) a single U.S. transferor owns more than 50 percent of the transferee foreign corporation (and, thus, whether gain is recognized) takes into account both stock of the transferee foreign corporation received by the U.S. transferor(s) in the exchange and stock in the transferee foreign corporation owned by the U.S. transferor(s) independent of the exchange (referred to as cross-ownership).

Notice 87–85 and the 1991 proposed regulations presume that U.S. transferors own in the aggregate 50 percent or more of the total voting power or the total value of the transferee foreign corporation immediately after the transfer (and thus a ten-year GRA is required), unless U.S. transferors can demonstrate otherwise (referred to as the ownership presumption). The ownership presumption contained in both the Notice and the 1991 proposed regulations actually consists of two rebuttable presumptions, one relating to ownership of stock in the U.S. corporation the stock or securities of which are transferred (referred to as the U.S. target company) and the other relating to ownership of stock in the transferee foreign corporation.

Under the first presumption, all persons that exchange U.S. target company stock (or other property) for stock of the transferee foreign corporation in the exchange are presumed to be U.S. persons. Thus, if shareholders of the U.S. target company receive 50 percent or more of the stock of the transferee foreign corporation in the exchange, U.S. transferors are presumed to own 50 percent or more of the stock of the transferee foreign corporation immediately after the transfer. Even if application of this first presumption does not result in U.S. transferors being deemed to own at least 50 percent of the total voting power or the total value of the transferee foreign corporation immediately after the transfer, the second presumption may do so. The second presumption is that U.S. transferors also own stock of the transferee foreign corporation independent of the exchange in an amount sufficient to bring their total ownership immediately after the exchange up to 50 percent. This second component of the ownership presumption is referred to as the cross-ownership presumption.

Notice 94–46

Notice 94–46 modified the exceptions set forth in Notice 87–85 with respect to post-April 17, 1994 transfers of stock or securities of domestic corporations. The purpose of Notice 94–46 was to forestall outbound transfers that are structured to avoid or that lay a foundation for future avoidance of the Internal Revenue Code anti-deferral regimes by imposing a shareholder-level tax on such transfers. Notice 94–46 stated that regulations would provide that the transfer of stock or securities of a domestic corporation by a U.S. person to a foreign corporation described in section 367(a) would be taxable if all U.S. transferors owned, in the aggregate, 50 percent or more of either the total voting power or the total value of the stock of the transferee corporation immediately after the exchange. All U.S. transferors, regardless of their level of ownership, would be subject to tax in such a case.

The rules of Notice 94–46 incorporated the ownership presumption of Notice 87–85. As a result of the cross- ownership aspect of that presumption, even if U.S. shareholders receive significantly less than 50 percent of the stock of a transferee foreign corporation in an exchange described in section 367(a), the transaction could still be taxable. If, for example, U.S. shareholders of a U.S. target company received 30 percent of the stock of a transferee foreign corporation in an exchange described in section 367(a)(1), those shareholders would be presumed to own independently at least an additional 20 percent of the stock of the transferee foreign corporation immediately after the transfer, with the result that the exchange would be taxable (unless the cross-ownership presumption were rebutted). Commentators argued that where a U.S. target company and a foreign acquirer were publicly traded or widely-held, taxpayers' ability to rebut the cross-ownership aspect of the ownership presumption was limited. As a result, Notice 94–46 potentially had the effect of forestalling acquisitions of U.S. public companies by larger foreign corporations in cases where they were unrelated and both engaged in the active conduct of a trade or business.

In response to comments received from taxpayers, and in particular with respect to the difficulties of rebutting the cross-ownership presumption, these temporary regulations modify positions taken in Notice 94–46 in two significant ways. First, the regulations shift the ownership threshold from ''50 percent or more'' to ''more than 50 percent'' so that a U.S. transferor may qualify for an exception to section 367(a) in cases where U.S. transferors, in the aggregate, receive exactly 50 percent of the stock of the transferee foreign corporation in the exchange. The relaxation of the ownership threshold was intended to give 50–50 joint ventures involving unrelated U.S. and foreign corporations that are engaged in active businesses the option of using a foreign transferee corporation. Where a foreign corporation is smaller than a U.S. corporation that it acquires, the transaction will still generally be taxable; it would not be taxable if the U.S. participant were the acquiring corporation in the transaction (or if another U.S. holding company were the acquiring corporation). Second, although the regulation retains the presumption that shareholders of the U.S. target company are U.S. persons, it does not, in general, retain the cross-ownership presumption and no longer, as a general matter, takes cross-ownership into account. The regulation counts cross-ownership only in the limited circumstance where U.S. officers, directors, and 5-percent or greater shareholders of the U.S. target company own, in the aggregate, more than 50 percent of the total voting power or the total value of the transferee foreign corporation immediately after the transfer (a control group case). In such a case, the exchange is taxable to all U.S. transferors. The regulation allows taxpayers to rely on Schedule 13–D or 13–G filings made under the Securities Exchange Act of 1934 (15 U.S.C. 78m) to identify 5-percent shareholders of public companies for this purpose.

Although cross-ownership does not count toward the 50 percent ownership threshold (unless the control group case applies), it is still relevant in determining whether a U.S. transferor owns five percent or more of the transferee foreign corporation under the rules originally announced in Notice 87–85. Moreover, cross-ownership continues to be relevant for determining whether a 5-year or 10-year GRA is required under the rules originally announced in 87–85, and, for these purposes, there continues to be a rebuttable presumption.

In addition to the two modifications described above that were made in response to comments received with respect to Notice 94–46, these regulations contain a new active trade or business requirement not contained in Notice 94–46, which taxpayers must meet in order to qualify for an exception to the general rule of taxation under section 367(a). The IRS and the Treasury Department added the active trade or business requirement to address abuse potential, in particular, in a case in which a U.S. target company is smaller than a foreign acquirer that was formed and capitalized with a view to enabling the smaller U.S. company to move offshore. The IRS and the Treasury Department believe that this type of transaction presents an inappropriate opportunity for avoiding the anti-deferral regime without payment of the tax envisioned by Notice 94–46. The IRS and the Treasury Department believe that an exception to taxation is proper only in cases where a combination of two active businesses is contemplated and that the opportunity for tax avoidance is ameliorated when such businesses have been conducted for a period of at least 36 months prior to the exchange. Under the requirement contained in the regulations, no exception to taxation is available unless either the transferee foreign corporation or an affiliate of that corporation was engaged in the active conduct of a trade or business for the entire 36-month period prior to the exchange, and unless such business is substantial in relation to the business conducted by the U.S. target company. For this purpose, an affiliate is generally defined by reference to the rules in section 1504(a) (without the exclusion of foreign corporations), and generally includes a parent, subsidiary or brother-sister corporation of the transferee foreign corporation.

To summarize, under the temporary regulations, a U.S. person that exchanges stock or securities in a U.S. corporation for stock of a foreign corporation in an exchange described in section 367(a) will be taxable in cases where:

(i) The 50 percent ownership threshold is exceeded;

(ii) The control group case applies;

(iii) The active trade or business requirement is not met; or

(iv) The exchanging U.S. shareholder owns five percent or more of the stock of the transferee foreign corporation and fails to enter into a GRA and/or satisfy the requirements of section 6038B.

The duration of the GRA in case (iv) is 5 years if the transferor can demonstrate that all U.S. transferors in the aggregate own less than 50 percent of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer or 10 years if U.S. transferors own exactly 50 percent (or more than 50 percent as a result of cross-ownership) of the transferee foreign corporation immediately after the transfer. In all cases other than those enumerated in (i) through (iv) above, a U.S. person that transfers stock or securities of a domestic corporation in exchange for stock of a transferee foreign corporation will not be taxable under section 367(a) if certain reporting requirements described in the regulations are met.

Final regulations under section 367(a) are expected to address the transfer of stock or securities of foreign corporations and other matters contained in the 1991 proposed regulations that are not addressed herein.

Special Analyses

It has been determined that this temporary regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that this regulation does not have a significant impact on a substantial number of small entities. Thus, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, a copy of these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Philip L. Tretiak of the Office of Associate Chief Counsel (International), within the Office of Chief Counsel, Internal Revenue Service. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and Recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

Part 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.367(a)-3T is amended by revising paragraphs (a), (c), (d), (e), (f), (g)(1) and (h)(1) to read as follows:

§ 1.367(a)-3T Treatment of transfers of stock or securities to foreign corporations (temporary).

(a) *In general.* This section provides rules concerning the transfer of stock or securities by a U.S. person to a foreign corporation in an exchange described in section 367(a). In general, a transfer of stock or securities by a U.S. person (directly, indirectly or constructively) to a foreign corporation that is described in section 351, 354 (pursuant to a reorganization described in section 368(a)(1)(B)) or section 361(a) or (b) is subject to section 367(a)(1) and, therefore, is treated as a taxable exchange, unless one of the exceptions set forth in paragraph (b), (c) or (d) of this section applies. For additional rules relating to an exchange involving a foreign corporation in connection with which there is a transfer of stock, see section 367(b) and the regulations under that section. For additional rules regarding a transfer of stock or securities in an exchange described in section 361(a) or (b), see section 367(a)(5) and any regulations under that section.

* * * * *

(c) *Transfers by U.S. persons of stock or securities of domestic corporations to foreign corporations*—(1) *In general.* Except as provided in section 367(a)(5), a transfer of stock or securities of a domestic corporation by a U.S. person to a foreign corporation that would otherwise be subject to section 367(a)(1) under paragraph (a) of this section shall not be subject to section 367(a)(1) if the domestic corporation the stock or securities of which are transferred (referred to as the U.S. target company) complies with the reporting requirements in paragraph (c)(4) of this section and if each of the following four conditions is met:

(i) Fifty percent or less of both the total voting power and the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by U.S. transferors (i.e., the amount of stock received does not exceed the 50 percent threshold).

(ii) No more than 50 percent of each of the total voting power and the total value of the stock of the transferee foreign corporation is owned, in the aggregate, immediately after the transfer by U.S. persons who are either officers or directors of the U.S. target company or who are five-percent target shareholders (as defined in paragraph (c)(6)(iii) of this section) (i.e., there is no control group). For purposes of this paragraph (c)(1)(ii), any stock of the transferee foreign corporation owned by U.S. persons immediately after the transfer will be taken into account, whether or not it was received in the exchange for stock or securities of the U.S. target company.

(iii) In the case of a transfer occurring after January 25, 1996, the transferee foreign corporation or an affiliate of the transferee foreign corporation has been engaged in the active conduct of a trade or business, within the meaning of § 1.367(a)-2T(b)(2) and (3), that is substantial in comparison to the trade or business of the U.S. target company, for the entire 36-month period immediately preceding the date of the transfer.

(iv) Either—

(A) The U.S. person is not a five-percent transferee shareholder (as defined in paragraph (c)(6)(ii) of this section); or

(B) The U.S. person is a five-percent transferee shareholder and enters into an agreement to recognize gain with respect to the U.S. target company stock or securities it exchanged in the form provided in paragraph (g) of this section, as modified by paragraph (c)(3) of this section (setting the duration of the gain recognition agreement).

(2) *Ownership Presumption.* For purposes of paragraph (c)(1) of this section, persons who transfer stock or securities of the U.S. target company or other property in exchange for stock of the transferee foreign corporation are presumed to be U.S. persons. This presumption may be rebutted in accordance with paragraph (c)(4)(ii) of this section.

(3) *Term of the gain recognition agreement.* If, immediately after the transfer described in section 367(a)(1), all U.S. transferors own in the aggregate less than fifty percent of both the total voting power and the total value of the stock of the transferee foreign corporation (counting both stock of the transferee foreign corporation owned as a result of the exchange as well as stock of the transferee foreign corporation owned independently by such U.S. transferors), the agreement to recognize gain shall be in the form specified in paragraph (g)(3) of this section. The term of the agreement shall be ten years, rather than the five years specified in paragraph (g)(3) of this section, the waiver described in paragraph (g)(4) of this section shall extend the period for assessment of tax for an additional five years, and the certification and waiver described in paragraph (g)(5) of this section must be filed for an additional five years if—

(i) The five-percent transferee shareholder cannot determine whether the condition in the preceding sentence is satisfied; or

(ii) Immediately after the transfer, all U.S. transferors own in the aggregate fifty percent or more of either the total voting power or the total value of the stock of the transferee foreign corporation (counting both stock of the transferee foreign corporation owned as a result of the exchange, as well as stock of the transferee foreign corporation owned independently by such U.S. transferors).

(4) *Reporting requirements of U.S. target company.* (i) In order for a U.S. person that transfers stock or securities of a domestic corporation to qualify for the exception to the general rule under section 367(a)(1) provided by this paragraph (c), the U.S. target company must comply with the reporting requirements contained in this paragraph (c)(4). The U.S. target company must attach to its timely filed U.S. income tax return (or a subsequent, timely filed amended return) for the taxable year in which the transfer occurs a statement titled ''Section 367(a)—Reporting of Cross-Border Transfer Under Reg. § 1.367(a)–3T(c)(4),'' signed under penalties of perjury by an officer of the corporation, disclosing the following information—

(A) A description of the transaction in which a U.S. person or persons transferred stock or securities in the U.S. target company to the transferee foreign corporation in a transfer otherwise subject to section 367(a)(1);

(B) The amount (specified as to the percentage of the total voting power and the total value) of stock of the transferee foreign corporation received in the transaction, in the aggregate, by persons who transferred stock or securities of the U.S. target company or other property. For additional information that may be required to rebut the ownership presumption of paragraph (c)(2) of this section in cases where more than 50 percent of either the total voting power or the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by persons who transferred stock or securities of the U.S. target company or other property, see paragraph (c)(4)(ii) of this section;

(C) The amount (if any) of transferee foreign corporation stock owned directly or indirectly (applying the attribution rules of sections 267(c)(1) and (5)) immediately after the exchange by the U.S. target company;

(D) A statement that there is no control group within the meaning of paragraph (c)(1)(ii) of this section;

(E) A list of U.S. persons who are officers, directors or five-percent target shareholders and the percentage of the total voting power and the total value of the stock of the transferee foreign corporation owned by such persons both immediately before and immediately after the transaction; and

(F) A statement that the active trade or business test described in paragraph (c)(1)(iii) of this section is satisfied by the transferee foreign corporation or an affiliate and a description of such business.

(ii) To rebut the ownership presumption of paragraph (c)(2) of this section, the U.S. target company must obtain ownership statements (described in paragraph (c)(6)(i) of this section) from a sufficient number of persons that transfer U.S. target company stock or securities (or other property) in the transaction that are not U.S. persons to demonstrate that the 50 percent threshold is not exceeded. In addition, the U.S. target company must attach to its timely filed U.S. income tax return (or a subsequent, timely filed amended return) for the taxable year in which the transfer occurs a statement, titled ''Section 367(a)—Compilation of Ownership Statements under Reg. § 1.367(a)– 3T(c),'' signed under penalties of perjury by an officer of the corporation, disclosing the following information:

(A) The amount (specified as to the percentage of the total voting power and the total value) of stock of the transferee foreign corporation received, in the aggregate, by U.S. transferors;

(B) The amount (specified as to the percentage of total voting power and total value) of stock of the transferee foreign corporation received, in the aggregate, by foreign persons that filed ownership statements;

(C) A summary of the information tabulated from the ownership statements, including—

(*1*) The names of the persons that filed ownership statements stating that they are not U.S. persons;

(*2*) The countries of residence and citizenship of such persons; and

(*3*) The ownership of such persons (by voting power and by value) in the U.S. target company prior to the exchange and the amount of stock of the transferee foreign corporation (by voting power and value) received by such persons in the exchange.

(iii) For purposes of paragraph (c)(4), an income tax return (including an amended return) will be considered timely filed if it is filed prior to the time that the Internal Revenue Service discovers that the reporting requirements of this paragraph have not been satisfied.

(5) *Special Rules*—(i) *Treatment of partnerships.* For purposes of paragraph (c), if a partnership (whether domestic or foreign) owns or transfers stock or securities or other property in an exchange described in section 367(a), each partner in the partnership, and not the partnership itself, is treated as owning and as having transferred a proportionate share of the stock or securities or other property. See § 1.367(a)–1T(c)(3).

(ii) *Treatment of options.* For purposes of paragraph (c) of this section, one or more options (or an interest similar to an option) will be treated as exercised and thus will be counted as stock for purposes of determining whether the 50 percent threshold is exceeded or whether a control group exists if a principal purpose of the issuance or the acquisition of the option (or other interest) was the avoidance of the general rule contained in section 367(a).

(iii) *U.S. target has a vestigial ownership interest in transferee foreign corporation.* In cases where, immediately after the transfer, the U.S. target company owns, directly or indirectly (applying the attribution rules of sections 267(c) (1) and (5)) stock of the transferee foreign corporation, that stock will not in any way be taken into account (and, thus, will not be treated as outstanding) in determining whether the 50 percent threshold under paragraph (c)(1)(i) of this section is exceeded or whether a control group under paragraph (c)(1)(ii) of this section exists.

(iv) *Attribution rule.* The rules of section 958 shall apply for purposes of determining the ownership of stock, securities or other property under this paragraph (c).

(6) *Definitions*—(i) *Ownership statement.* An ownership statement is a statement, signed under penalties of perjury, stating—

(A) The identity and taxpayer identification number, if any, of the person making the statement;

(B) That the person making the statement is not a U.S. person (as defined in paragraph (c)(6)(iv) of this section);

(C) That the person making the statement is not related to any U.S. person to whom the stock or securities owned by the person making the statement are attributable under the rules of section 958, or, if stock or securities are so attributable, the identity and taxpayer identification number of the relevant U.S. person;

(D) The citizenship, permanent residence, home address, and U.S. address, if any, of the person making the statement; and

(E) The ownership such person has (by voting power and by value) in the U.S. target company prior to the exchange and the amount of stock of the transferee foreign corporation (by voting power and value) received by such person in the exchange.

(ii) *Five-percent transferee shareholder.* A five-percent transferee shareholder is a person that owns at least five percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer described in section 367(a)(1). For special rules involving cases in which stock is held by a partnership, see paragraph (c)(5)(i) of this section.

(iii) *Five-percent target shareholder.* A five-percent target shareholder is a person that owns at least five percent of either the total voting power or the total value of the stock of the U.S. target company immediately prior to the transfer described in section 367(a)(1). If the stock of the U.S. target company is described in Rule 13d–1(d) of Regulation 13D (17 CFR 240.13d–1(d)) (or any rule or regulation to generally the same effect), promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 USC 78m), the existence or absence of filings of Schedule 13–D or 13–G (or any similar schedules) may be relied upon for purposes of identifying five-percent target shareholders. For special rules involving cases in which U.S. target company stock is held by a partnership, see paragraph (c)(5)(i) of this section.

(iv) *U.S. Person.* For purposes of this section, a U.S. person is defined by reference to § 1.367(a)–1T(d)(1). For application of the rules of this section to stock or securities owned or transferred by a partnership that is a U.S. person, however, see paragraph (c)(5)(i) of this section.

(v) *U.S. Transferor.* A U.S. transferor is a U.S. person (as defined in paragraph (c)(6)(iv) of this section) who transfers directly, indirectly or constructively stock or securities of the U.S. target company or other property in exchange for stock of the transferee foreign corporation in an exchange described in section 367.

(vi) *Transferee foreign corporation.* A transferee foreign corporation is the foreign corporation whose stock is received in the exchange by U.S. persons.

(vii) *Affiliate.* An affiliate is a corporation that is a member of the same affiliated group (as defined in section 1504(a), without regard to section 1504(b)(3)) as the transferee foreign corporation.

(7) *Certain transfers in connection with performance of services.* Section 367(a)(1) shall not apply to a domestic corporation's transfer of its own stock or securities in connection with the performance of services, if the transfer is considered to be to a foreign corporation solely by reason of § 1.83–6(d)(1).

(8) *Examples.* This paragraph (c) may be illustrated by the following examples:

Example 1. Ownership presumption. (i) FC, a foreign corporation, issues 51 percent of its stock to the shareholders of S, a domestic corporation, in exchange for their S stock, in a transaction described in section 367(a)(1).

(ii) Under paragraph (c)(2) of this section, all shareholders of S who receive stock of FC in the exchange are presumed to be U.S. persons. Unless this ownership presumption is rebutted, the condition set forth in paragraph (c)(1)(i) of this section will not be satisfied, and the exception in paragraph (c)(1) of this section will not be available. As a result, all U.S. persons that transferred S stock will recognize gain on the exchange. To rebut the ownership presumption, S must comply with the reporting requirements contained in paragraph (c)(4)(ii) of this section, obtaining ownership statements (described in paragraph (c)(6)(i) of this section) from a sufficient number of non-U.S. persons who received FC stock in the exchange to demonstrate that the amount of FC stock received by U.S. persons in the exchange does not exceed 50 percent.

Example 2. Filing of Gain Recognition Agreement. (i) The facts are the same as in *Example 1,* except that FC issues only 40 percent of its stock to the shareholders of S in the exchange. FC satisfies the active trade or business test (described in paragraph (c)(1)(iii) of this section). A, a U.S. person, owns 10 percent of S's stock immediately before the transfer. All other shareholders of S own less than five percent of its stock. None of S's officers or directors owns any stock in FC immediately after the transfer. A will own 15 percent of the stock of FC immediately after the transfer, 4 percent received in the exchange, and the balance being stock in FC that A owned prior to and independent of the transaction. No S shareholder besides A owns five percent or more of FC immediately after the transfer. The reporting requirements under paragraph (c)(4)(i) of this section are satisfied.

(ii) The condition set forth in paragraph (c)(1)(i) of this section is satisfied because, even after application of the presumption in paragraph (c)(2) of this section, U.S. transferors could not receive more than 50 percent of FC's stock in the transaction. There is no control group because five-percent target shareholders and officers and directors of S do not, in the aggregate, own more than 50 percent of the stock of FC immediately after the transfer (A, the sole five-percent target shareholder, owns 15 percent of the stock of FC immediately after the transfer, and no officers or directors of S own any stock of FC immediately after the transfer). Therefore, the condition set forth in paragraph (c)(1)(ii) of this section is satisfied (and A's cross-ownership of FC stock is not taken into account). The facts assume that the condition set forth in paragraph (c)(1)(iii) of this section is satisfied. Thus, U.S. persons that are not five-percent transferee shareholders will not recognize gain on the exchange of S shares for FC shares. A, a five-percent transferee shareholder, will not be required to include in income any gain realized on the exchange in the year of the transfer if he files a gain recognition agreement (GRA) and complies with section 6038B. The duration of the GRA is five years if all U.S. transferors own in the aggregate less than 50 percent of the total voting power and the total value of FC immediately after the transfer, and ten years if this condition is not satisfied. If A lacks the information to determine whether he is eligible to file a five-year GRA (because the determination includes a cross-ownership inquiry for all U.S. transferors), he is required to file a ten-year GRA.

Example 3. Control Group. (i) The facts are the same as in *Example 2,* except that B, another U.S. person, is a 5- percent target shareholder, owning 25 percent of S's stock immediately before the transfer. B owns 40 percent of the stock of FC immediately after the transfer, 10 percent received in the exchange, and the balance being stock in FC that B owned prior to and independent of the transaction.

(ii) A control group exists because A and B, each a five-percent target shareholder within the meaning of paragraph (c)(6)(iii) of this section, together own more than 50 percent of FC immediately after the transfer (counting both stock received in the exchange and stock owned prior to and independent of the exchange). As a result, the condition set forth in paragraph (c)(1)(ii) of this section is not satisfied, and all U.S. persons (not merely A and B) who transferred S stock will recognize gain on the exchange.

Example 4. Partnerships. (i) The facts are the same as in *Example 3,* except that B is a partnership (domestic or foreign) that has five equal partners, only two of whom, X and Y, are U.S. persons. X and Y are treated as the owners and transferors of 5 percent each of the S stock owned and transferred by B and as owners of 8 percent each of the FC stock owned by B immediately after the transfer. Five-percent target shareholders thus own a total of 31 percent of the stock of FC immediately after the transfer (A's 15 percent, plus X's 8 percent, plus Y's 8 percent).

(ii) Because no control group exists, the condition in paragraph (c)(1)(ii) of this section is satisfied. The conditions in paragraphs (c)(1) (i) and (iii) of this section also are satisfied. Thus, U.S. persons that are not five- percent transferee shareholders will not recognize gain on the exchange of S shares for FC shares. A, X, and Y, each a five-percent transferee shareholder, will not be required to include in income in the year of the transfer any gain realized on the exchange if they file GRAs and comply with section 6038B. The duration of the GRA is five years if all U.S. transferors own in the aggregate less than 50 percent of the total voting power and the total value of FC immediately after the transfer, and ten years if this condition is not satisfied. If A, X, and Y lack the information to determine whether they are eligible to file five-year GRAs (because the determination includes a cross-ownership inquiry for all U.S. transferors), they are required to file ten-year GRAs.

(9) *Effective date.* This paragraph (c) applies to transfers occurring after April 17, 1994. However, paragraph (c)(1)(iii) of this section applies only to transfers occurring after January 25, 1996. For transfers occurring before December 17, 1987, see § 1.367(a)–3T(c) (1) through (4) as contained in 26 CFR Part 1 revised April 1, 1995.

(d) *Transfers of stock or securities of foreign corporations.* For guidance, see Notice 87–85 (1987–2 C.B. 395). See § 601.601(d)(2) of this chapter.

(e) [Reserved.] For transfers occurring before December 17, 1987, see § 1.367(a)–3T(e) as contained in 26 CFR Part 1 revised April 1, 1995.

(f) [Reserved.] For transfers occurring before December 17, 1987, see § 1.367(a)–3T(f) as contained in 26 CFR Part 1 revised April 1, 1995.

(g) *Transferor's agreement to recognize gain upon later disposition by transferee*—(1) *In general.* A transfer of stock or securities shall not be subject to section 367(a)(1) if—

(i) The transferor complies with the reporting requirements of section 6038B and any regulations thereunder; and

(ii) The transferor files a binding agreement to recognize gain upon the transferee corporation's later disposition of the transferred stock or securities, in accordance with the rules of this section.

* * * * *

(h) *Anti-abuse rules.*

(1) [Reserved.] For transfers occurring before December 17, 1987, see § 1.367(a)–3T(h)(1) as contained in 26 CFR Part 1 revised April 1, 1995.

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority for citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In § 602.101, paragraph (c) is amended by revising the entry in the table for ''1.367(a)–3T'' to read as follows:

''1.367(a)–3T .... 0026 1478''.

Dated: December 13, 1995.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

Approved:

Leslie Samuels,

Assistant Secretary of the Treasury.

[FR Doc. 95–30829 Filed 12–22–95; 8:45 am]

BILLING CODE 4830–01–U

DEPARTMENT OF TRANSPORTATION

Coast Guard

33 CFR Part 117

[CGD07–94–85]

RIN 2115–AE47

Drawbridge Operation Regulations; Okeechobee Waterway, FL

AGENCY: Coast Guard, DOT.

ACTION: Final rule.

SUMMARY: The Coast Guard is changing regulations governing the operation of the Florida East Coast railroad bridge, at mile 38.0, at Port Mayaca, Florida, by removing the authorization for automatic operation and returning the draw to manual operation. This action should accommodate the needs of railroad traffic, while still providing for the reasonable needs of navigation.

EFFECTIVE DATE: January 25, 1996.

ADDRESSES: Documents in this preamble are available for inspection and copying at 909 SE 1st Ave, room 406 between 7 am and 4 pm Monday through Friday, except federal holidays. The telephone number is (305) 536–4103.

FOR FURTHER INFORMATION CONTACT:

Walter Paskowsky, Project Manager, Bridge Section at (305) 536–4103.

SUPPLEMENTARY INFORMATION:

Drafting Information

The principal persons involved in drafting this document are Walter Paskowsky, Project Manager, and LCDR Robert Wilkins, Project Counsel.

Regulatory History

On August 17, 1995 the Coast Guard published a notice of proposed rulemaking entitled Drawbridge Operations Regulations, Okeechobee Waterway, Florida in the Federal Register (FR 60 42827). No adverse comments were received. A public hearing was not requested and was not held.

Background and Purpose

The bridge is normally in the fully open position displaying flashing green lights to indicate that vessels may pass. When a train approaches the bridge, the lights go to flashing red and a horn sounds four blasts, and then repeats four blasts. After an eight minute delay, the draw lowers and locks, providing the scanning equipment reveals nothing under the draw. The draw remains down for a period of eight minutes or while all circuits are occupied. After the train has cleared, the draw opens and the lights return to flashing green. Because of declining usage of the rail line, the bridgeowner, Florida East Coast Railroad, has requested permission to operate the span manually.

Discussion of Comments and Changes

Three comments were received in response to the Notice of Proposed Rulemaking. The US Army Corps of Engineers stated the proposed rule change would not impact navigational interests using the waterway and, therefore, had no objection to the proposed change. The Florida State Historic Preservation Office indicated the proposed change would have no effect on any sites listed or eligible for listing in the National Register. The US National Marine Fisheries Service anticipates the change will have no impact to resources for which they have stewardship responsibility. No objections were received, therefore the final rule is unchanged from the Notice of Proposed Rulemaking.

Regulatory Evaluation

This rule is not a significant regulatory action under section 3(f) of Executive Order 12866 and does not require an assessment of potential costs and benefits under section 6(a)(3) of that order. It has not been reviewed by the Office of Management and Budget under that order. It is not significant under the regulatory policies and procedures of the Department of Transportation (DOT) (44FR 11040; February 26, 1979). The Coast Guard expects the economic impact of this proposal to be so minimal that a full regulatory Evaluation under paragraph 10e of the regulatory policies and procedures of DOT (44 FR 11040; February 26, 1979 is unnecessary. We conclude this because only a few trains cross the bridge weekly.

Small Entities

Under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the Coast Guard must consider whether this rule will have a significant economic impact on a substantial number of small entities. ''Small entities'' include independently owned and operated small businesses that are not dominant in their field and that otherwise qualify as ''small business concerns'' under section 3 of the Small Business Act (15 U.S.C. 632). Because only a few trains cross the bridge weekly, the Coast Guard certifies under 5 U.S.C. 605(b) that this final rule will not have a significant impact on a substantial number of small entities.

Collection of Information

This proposal contains no collection of information requirements under the Paperwork Reduction Act (44 U.S.C. 3501 et seq.).

Federalism

The Coast Guard has analyzed this proposal under the principles and criteria contained in Executive Order 12612, and has determined that this proposal does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

Environment

The Coast Guard considered the environmental impact of this proposal and concluded that, under section 2.B.2.e.(32)(e) of Commandant Instruction M16475.1B, promulgation of operating requirements or procedures for drawbridges is categorically excluded from further environmental documentation. A Categorical Exclusion Determination is available in the docket.

List of Subjects in 33 CFR Part 117

Bridges.

For the reasons set out in the preamble, the Coast Guard amends 33 CFR Part 117 as follows:

PART 117—DRAWBRIDGE OPERATION REGULATIONS

1. The authority citation for Part 117 continues to read as follows: